STATE OF CALIFORNIA

GOVERNOR'S BUDGET

May Revision

2005-06

Introduction

The new estimates contained in this May Revision reflect a restored faith in the California economy. Revenues are increasing in the 2004-05 estimated personal income tax, and in the 2005-06 corporate tax. The state's unemployment rate has dropped a full point from 6.4 percent a year ago to 5.4 percent in the latest month report. And with a more vibrant economy, the populations of those receiving assistance from the state have declined, allowing further budget savings. Savings in workers' compensation are beginning to be realized in the cost of doing business. The reported earnings of California companies are up. The prospect of a Governor willing to use his veto pen to preserve a healthy economic environment for California has been observed in the job-creating community. The fact that this budget does not include tax increases also sends a signal of tremendous value to those with jobs to offer: California has come to grips with its spending problems. The state won't run away from the spending habits that got us into trouble by patching things over with a tax increase.

Nevertheless, national economic trends point toward a slowing of the recovery, nationally, and in California, after 2006. It is difficult to predict economic trends more than a year out; but to the extent we can, they show continued economic growth at a slower pace. The result is that the new revenue we see cannot be counted on for the years thereafter. Accordingly, the prudent thing is to treat the largest portion of the new revenue predicted since January as one-time rather than permanent.

The wisest action to take when a state has one-time money is to borrow less. The May Revision has no new borrowing at all. We do not make any further borrowings from the Economic Recovery Bonds authorized by the taxpayers in Proposition 57. Leaving more room for those bonds should difficulties arise in future years demonstrates fiscal responsibility. And we are able to pay back 50 percent of the Vehicle License Fee Gap due to local governments. That infusion of about $600 million dollars will further help local units of government to respond to their needs.

Further, the state is able to make a substantial boost in rebuilding its infrastructure by allowing all the money in the Proposition 42 account to go to its intended purpose. This will help cities and counties immensely as they cope with the growing demands on their roads, bridges, ports, utilities, and airports.

This is a budget that builds: it builds confidence in the restoration of our fiscal system in California, builds roads and infrastructure for our state's vital needs, and builds on the positive relationship between local government and the state started in Proposition 1A by restricting the state from raiding local government. It also builds on our state's schools, our human infrastructure for years to come. We are able to fund fully all the population growth, inflation, and cost shifts schools will encounter, and dedicate a substantial sum to reducing class size, rewarding good teachers, and improving teacher preparation as well.

Despite this good news, systemic budget problems remain. We started this fiscal year with a budget gap of $8.6 billion. With this budget, we reach balance with no new borrowing. But next fiscal year, we start all over again—likely beginning the year in deficit as automatic spending formulas continue to demand higher amounts of spending whether or not the revenue is there to support those levels.

We should strive to fix the budget process of California not just in this year, but for the long-term as well. We can do it; this budget points the way to how.